

Financing Your Remodeling Project

One of the most important considerations for your home improvement project is financing. After all, the project will go nowhere if you can't pay for it.

Fortunately, there are several options that can provide the dollars you need. Four of the most common are a home improvement loan, a home equity line of credit, a home equity loan (second mortgage), and a cash-out refinancing of your current mortgage. However, the simplest method of financing is cash.

Cash

If you have cash in savings to pay for your remodeling project, this may be the best way to finance your home improvements. But be sure to consider the fact that, by paying in cash, you tie up money that could be earning interest in other investments. In other words, you need to look at the interest rate that you would be charged by financing the project and compare this to the interest you could earn by investing these funds.

Also remember that interest payments on a home improvement loan may be tax-deductible, while you can't write off the expenses of a remodeling project paid for in cash. Crunch the numbers and meet with a financial advisor to determine whether paying in cash will really pay off in the long run.



Home Improvement Loan

Two special loans administered through the Federal Housing Administration (FHA) are the Title I and Section 203(k) programs. A Title I loan allows you to borrow up to \$25,000 for improvements to a single-family home. These are fixed-rate loans that FHA insures against the risk of default. Loans must be made by an approved Title I lender.

The 203(k) program is not as well known, but if you are looking to purchase a fixer-upper, it is a terrific opportunity. It allows home owners to receive a single, long-term, fixed or adjustable rate loan that covers both the acquisition and rehabilitation of the property. To obtain a loan under the 203(k) program, you must use an FHA-approved lending institution. Most mortgage lenders are approved to make loans through this program.

Home Equity Line of Credit

A home equity line of credit is a form of revolving credit in which your home serves as collateral. This allows you to tap into these funds whenever you need it. The credit line is usually set at 75 to 80 percent of the appraised value of your home minus the balance of the first mortgage. Your credit history and ability to pay may also be considered in determining the amount of credit available.

Home equity lines of credit usually carry a variable interest rate that is figured by adding a margin to the current Prime Rate or some other index. Other costs associated with setting up a line of credit may also apply and will vary from lender to lender.

Second Mortgage

If you are not comfortable with the open-ended nature of a line of credit (which requires discipline to ensure that you don't go way over budget), a home equity loan, or second mortgage, may be right for you. This is a fixed-rate, fixed-term loan based on the equity in your house that is paid back in equal monthly installments over a specific period of time.

Cash-Out Refinancing

If interest rates today are significantly less than when you first purchased your house, refinancing your mortgage may be a wise move. This refinancing alternative allows

you to use the accumulated equity in your home to take out a new loan to pay off your existing mortgage and then use the remaining funds for your remodeling project.

Make sure you factor in the length of time you plan to live in the house and the number of years left on your current mortgage before you decide to refinance.

Keeping Your Budget in Line

Once you've decided how much you can afford to spend fulfilling your remodeling dreams, the real challenge is making sure you stick to this budget. So, how can you prevent your expenses from spiraling out of control?

- Plan on spending only 80 percent of what you can afford. Put the additional 20 percent in reserve to cover changes, unforeseen problems, and miscellaneous charges.
- Remember that anything not included in the original contract will cost extra. It's very easy to start tacking on hundreds and even thousands of dollars in change orders that will break both your budget and your timeline.

Stay focused on the task at hand. Stick to the project you have planned rather than deciding that now is the time to overhaul the rest of the house

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